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**U.S. SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

☒ Quarterly report Pursuant to section 13 or 15(d) of the Securities and Exchange act of 1934  
**For the quarter ended September 30, 2004**

☐ Transition report pursuant to section 13 or 15(d) of the Securities and Exchange act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission file number 0-23881**

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**COWLITZ BANCORPORATION**

**(Exact name of registrant as specified in its charter)**

**Washington**  
(State or other jurisdiction  
of incorporation or organization)

**91-1529841**  
(I.R.S. Employer  
Identification No.)

**927 Commerce Ave., Longview, Washington 98632**  
(Address of principal executive offices) (Zip Code)

**(360) 423-9800**  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act)

Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, no par value on October 31, 2004: 4,170,975 shares

**COWLITZ BANCORPORATION AND SUBSIDIARY  
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**Forward-Looking Statements**

*Management's discussion and the information in this document and the accompanying financial statements contain forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identifiable by words such as "expect", "believe", "intend", "anticipate", "estimate" or similar expressions, and are subject to risks and uncertainties that could cause actual results to differ materially from those stated. Examples of such risks and uncertainties that could have a material adverse effect on the operations and future prospects of the Company, and could render actual results different from those expressed in the forward-looking statements, include, without limitation: changes in general economic conditions, competition for financial services in the market area of the Company, the level of demand for loans, quality of the loan and investment portfolio, deposit flows, legislative and regulatory initiatives, and monetary and fiscal policies of the U.S. Government affecting interest rates. The reader is advised that this list of risks is not exhaustive and should not be construed as any prediction by the Company as to which risks would cause actual results to differ materially from those indicated by the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements.*

**Part I. FINANCIAL INFORMATION**  
**Item 1. Financial Statements**

**COWLITZ BANCORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CONDITION**  
(dollars in thousands)

	September 30, <u>2004</u>	December 31, <u>2003</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 6,914	\$ 24,527
Investment securities:		
Available-for-sale (at fair value, cost of \$58,400 and \$46,658 at September 30, 2004 and December 31, 2003, respectively)	58,817	47,000
Held-to-maturity (at amortized cost, fair value of \$385 and \$8,270 at September 30, 2004 and December 31, 2003, respectively)	<u>385</u>	<u>8,144</u>
Total investment securities	59,202	55,144
Federal Home Loan Bank stock, at cost	1,047	1,974
Loans held-for-sale	-	8,360
Loans, net of deferred loan fees	186,692	163,490
Allowance for loan losses	<u>(3,942)</u>	<u>(3,968)</u>
Total loans, net	182,750	159,522
Cash surrender value of bank-owned life insurance	8,502	8,170
Premises and equipment, net of accumulated depreciation of \$4,625 and \$4,350 at September 30, 2004 and December 31, 2003, respectively	3,961	4,171
Goodwill, net of impairment adjustments and accumulated amortization of \$1,987 at September 30, 2004 and December 31, 2003	852	852
Intangible assets, net of accumulated amortization of \$1,933 and \$1,734 at September 30, 2004 and December 31, 2003, respectively	37	236
Accrued interest receivable and other assets	<u>5,174</u>	<u>5,843</u>
<b>TOTAL ASSETS</b>	<u><u>\$ 268,439</u></u>	<u><u>\$ 268,799</u></u>
<b>LIABILITIES</b>		
Deposits:		
Non-interest-bearing demand	\$ 55,172	\$ 60,572
Savings and interest-bearing demand	78,014	86,375
Certificates of deposit	<u>88,030</u>	<u>79,533</u>
Total deposits	221,216	226,480
Federal funds purchased	9,300	225
Federal Home Loan Bank notes payable	518	5,653
Other borrowings	39	2,739
Accrued interest payable and other liabilities	<u>2,258</u>	<u>1,900</u>
<b>TOTAL LIABILITIES</b>	233,331	236,997
<b>SHAREHOLDERS' EQUITY</b>		
Preferred stock, no par value; 5,000,000 shares authorized; no shares issued and outstanding at September 30, 2004 and December 31, 2003	-	-
Common stock, no par value; 25,000,000 shares authorized; with 4,165,975 and 3,898,652 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	19,453	17,957
Additional paid-in capital	2,017	1,609
Retained earnings	13,364	12,011
Accumulated other comprehensive income, net of taxes	<u>274</u>	<u>225</u>
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<u><u>35,108</u></u>	<u><u>31,802</u></u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u><u>\$ 268,439</u></u>	<u><u>\$ 268,799</u></u>

*See accompanying notes*

**COWLITZ BANCORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(dollars in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
<b>INTEREST INCOME</b>				
Interest and fees on loans	\$ 3,207	\$ 3,439	\$ 9,335	\$ 11,451
Interest on taxable investment securities	501	205	1,420	659
Interest on non-taxable investment securities	96	27	261	36
Other interest and dividend income	19	115	111	450
Total interest income	<u>3,823</u>	<u>3,786</u>	<u>11,127</u>	<u>12,596</u>
<b>INTEREST EXPENSE</b>				
Savings and interest-bearing demand	202	276	592	915
Certificates of deposit	490	682	1,469	2,546
Federal funds purchased	12	3	17	15
Federal Home Loan Bank notes payable	10	107	40	361
Other borrowings	13	57	99	172
Total interest expense	<u>727</u>	<u>1,125</u>	<u>2,217</u>	<u>4,009</u>
Net interest income before provision (benefit) for loan losses	3,096	2,661	8,910	8,587
<b>PROVISION (BENEFIT) FOR LOAN LOSSES</b>	<u>73</u>	<u>(36)</u>	<u>160</u>	<u>530</u>
Net interest income after provision (benefit) for loan losses	<u>3,023</u>	<u>2,697</u>	<u>8,750</u>	<u>8,057</u>
<b>NON-INTEREST INCOME</b>				
Service charges on deposit accounts	174	211	535	695
(Losses) gains on loans sold	(17)	1,110	122	4,106
Mortgage brokerage fees	73	336	327	1,830
Escrow fees	-	244	-	905
Credit card income	159	175	436	471
Fiduciary income	104	70	302	240
Increase in cash surrender value of bank-owned life insurance	96	74	332	74
Net gains on sale of available for sale securities	8	-	8	-
Net gains (losses) on sale of repossessed assets	6	(87)	(9)	(50)
Other income	32	42	112	108
Total non-interest income	<u>635</u>	<u>2,175</u>	<u>2,165</u>	<u>8,379</u>
<b>NON-INTEREST EXPENSE</b>				
Salaries and employee benefits	1,499	2,208	4,732	7,297
Net occupancy and equipment expense	353	566	1,165	1,778
Professional fees	187	329	528	1,275
Business taxes	69	79	173	310
FDIC insurance assessment	8	119	215	390
Credit card expense	154	163	420	469
Data processing and communications	73	126	227	363
Loan expense	-	116	27	469
Postage and freight	55	104	176	335
Travel and education	45	65	125	202
Stationery and supplies	29	54	96	169
Temporary help	53	45	59	338
Amortization of intangible assets	66	66	199	199
Expenses relating to other real estate owned	29	46	71	147
Other expenses	350	319	947	788
Total non-interest expense	<u>2,970</u>	<u>4,405</u>	<u>9,160</u>	<u>14,529</u>
Income before provision for income taxes	688	467	1,755	1,907
<b>INCOME TAX PROVISION</b>	<u>171</u>	<u>147</u>	<u>402</u>	<u>659</u>
<b>NET INCOME</b>	<u>\$ 517</u>	<u>\$ 320</u>	<u>\$ 1,353</u>	<u>\$ 1,248</u>
<b>BASIC EARNINGS PER SHARE OF COMMON STOCK</b>	<u>\$ 0.13</u>	<u>\$ 0.08</u>	<u>\$ 0.34</u>	<u>\$ 0.32</u>
<b>DILUTED EARNINGS PER SHARE OF COMMON STOCK</b>	<u>\$ 0.13</u>	<u>\$ 0.08</u>	<u>\$ 0.34</u>	<u>\$ 0.31</u>
<b>WEIGHTED-AVERAGE SHARES OUTSTANDING – BASIC</b>	<u>4,004,149</u>	<u>3,872,052</u>	<u>3,941,902</u>	<u>3,842,438</u>
<b>WEIGHTED-AVERAGE SHARES OUTSTANDING – DILUTED</b>	<u>4,097,244</u>	<u>4,037,631</u>	<u>4,037,722</u>	<u>3,967,981</u>

See accompanying notes

**COWLITZ BANCORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
(dollars in thousands)

	<u>Common stock</u>		<u>Additional</u>	<u>Retained</u>	<u>Accumulated</u>	<u>Total</u>	<u>Comprehensive</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u>	<u>Earnings</u>	<u>Other</u>	<u>Shareholders'</u>	<u>Income (loss)</u>
			<u>Capital</u>		<u>Comprehensive</u>	<u>Equity</u>	
					<u>Income</u>		
<b>BALANCE, December 31, 2002</b>	3,818,272	\$ 17,491	\$ 1,538	\$ 11,894	\$ 340	\$ 31,263	
Comprehensive income:							
Net income	-	-	-	117	-	117	\$ 117
Net changes in unrealized gains on investments available-for-sale, net of deferred taxes of \$42	-	-	-	-	(115)	(115)	<u>(115)</u>
Comprehensive income							<u>\$ 2</u>
Proceeds from the exercise of stock options	80,380	466	-	-	-	466	
Tax benefit from the exercise of stock options	-	-	71	-	-	71	
<b>BALANCE, December 31, 2003</b>	3,898,652	17,957	1,609	12,011	225	31,802	
Comprehensive income:							
Net income	-	-	-	1,353	-	1,353	\$ 1,353
Net unrealized gains on investments reclassified from held-to-maturity to available-for-sale, net of deferred taxes of \$134	-	-	-	-	261	261	261
Net changes in unrealized gains on investments available-for-sale, net of deferred taxes of \$109	-	-	-	-	(212)	(212)	<u>(212)</u>
Comprehensive income							<u>\$ 1,402</u>
Proceeds from the exercise of stock options	267,323	1,496	-	-	-	1,496	
Tax benefit from the exercise of stock options	-	-	408	-	-	408	
<b>BALANCE, September 30, 2004</b>	<u>4,165,975</u>	<u>\$ 19,453</u>	<u>\$ 2,017</u>	<u>\$ 13,364</u>	<u>\$ 274</u>	<u>\$ 35,108</u>	

*See accompanying notes*

**COWLITZ BANCORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(dollars in thousands)

	<b>Nine Months Ended September 30,</b>	
	<b><u>2004</u></b>	<b><u>2003</u></b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income from operations	\$ 1,353	\$ 1,248
Adjustments to reconcile net income to net cash from operating activities:		
Deferred tax expense	-	52
Depreciation and amortization	503	604
Provision for loan losses	160	530
Increase in cash surrender value of bank-owned life insurance	(332)	(74)
Federal Home Loan Bank stock dividends	(40)	(95)
Net gains on maturities and sales of investment securities available-for-sale	(8)	-
Net amortization of investment security premiums and accretion of discounts	259	101
Net losses on sales of foreclosed assets	9	50
Net (gains) losses on the sale and disposal of premises and equipment	(4)	11
Net gains on loans sold	(122)	(4,106)
Origination of loans held-for-sale	(3,019)	(334,781)
Proceeds from loan sales	10,663	391,311
Decrease in accrued interest receivable and other assets	504	811
Increase (decrease) in accrued interest payable and other liabilities	<u>358</u>	<u>(777)</u>
Net cash from operating activities	<u>10,284</u>	<u>54,885</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from maturities of investment securities held-to-maturity	95	-
Proceeds from maturities and sales of investment securities available-for-sale	20,707	17,967
Purchases of held-to-maturity investment securities	(380)	(4,965)
Purchases of available-for-sale investment securities	(24,656)	(22,586)
Proceeds from redemption of Federal Home Loan Bank stock	977	428
Purchase of Federal Home Loan Bank stock	(10)	-
Net (increase) decrease in loans	(23,071)	24,529
Proceeds from sale of foreclosed assets	1,059	1,634
Purchases of premises and equipment	(94)	(331)
Proceeds from the sale of premises and equipment	4	3
Purchase of bank-owned life insurance	<u>-</u>	<u>(8,000)</u>
Net cash from investment activities	<u>(25,369)</u>	<u>8,679</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net decrease in savings, noninterest-bearing and interest-bearing demand deposits	(13,761)	(5,028)
Net increase (decrease) in certificates of deposit	8,497	(55,566)
Net increase (decrease) in federal funds purchased	9,075	(1,525)
Proceeds from Federal Home Loan Bank notes payable	10,000	-
Repayment of Federal Home Loan Bank notes payable	(15,135)	(10,135)
Proceeds from other borrowings	1,360	-
Repayment of other borrowings	(4,060)	(100)
Proceeds from the exercise of stock options	<u>1,496</u>	<u>389</u>
Net cash from financing activities	<u>(2,528)</u>	<u>(71,965)</u>
Net decrease in cash and cash equivalents	(17,613)	(8,401)
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	<u>24,527</u>	<u>43,691</u>
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<u><u>\$ 6,914</u></u>	<u><u>\$ 35,290</u></u>

See accompanying notes

COWLITZ BANCORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(amounts in thousands, except number of shares and per share amounts)

## 1. Nature of Operations

Cowlitz Bancorporation (the "Company") was organized in 1991 under Washington law to become the holding company for Cowlitz Bank (the "Bank"), a Washington state chartered bank that commenced operations in 1978. The principal executive offices of the Company are located in Longview, Washington. Cowlitz Bank operates four branches in Cowlitz County in southwest Washington. Outside of Cowlitz County, the Bank does business under the name Bay Bank with branches in Bellevue, Washington, and Portland, Oregon, a loan production office in Vancouver, Washington, and a limited service branch in a retirement center in Wilsonville, Oregon. The Oregon branches of Bay Bank were previously operated under the name Northern Bank of Commerce (NBOC). Cowlitz Bank also provides mortgage banking services through its Bay Mortgage division with offices in Longview, Castle Rock, Kalama, and Vancouver, Washington. During much of 2003, the Company also operated Bay Mortgage and Bay Escrow offices in Bellevue and Seattle, Washington. As part of a strategy to consolidate resources into commercial banking, and reduce reliance on mortgage lending activities, those offices were closed during the fourth quarter of 2003 and the first quarter of 2004.

The Company offers or makes available a broad range of financial services to its customers, primarily small and medium-sized businesses, professionals, and retail customers. The Bank's commercial and personal banking services include commercial and real estate lending, consumer lending, and trust services. The Company's goals are to offer exceptional customer service and to invest in the markets it serves through its business practices and community service.

## 2. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its subsidiary. All significant intercompany transactions and balances have been eliminated.

The interim financial statements have been prepared without an audit and in accordance with the instructions to Form 10-Q, generally accepted accounting principals, and banking industry practices. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, including normal recurring accruals necessary for a fair presentation of results of operations for the interim periods included herein have been made. The results of operations for the three and nine months ended September 30, 2004 are not necessarily indicative of results to be anticipated for the year ending December 31, 2004.

## 3. Cash and Cash Equivalents

For the purpose of presentation in the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold. Federal funds sold generally mature the day following purchase.

## 4. Use of Estimates in the Preparation of Financial Statements

Preparation of the consolidated financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Significant estimates include the allowance for loan losses and the carrying value of the Company's goodwill. Actual results could differ from those estimates.

## 5. Earnings Per Share

The following table reconciles the denominator of the basic and diluted earnings per share computations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Weighted-average shares – basic	4,004,149	3,872,052	3,941,902	3,842,438
Effect of assumed conversion of stock options	93,095	165,579	95,820	125,543
Weighted-average shares – diluted	<u>4,097,244</u>	<u>4,037,631</u>	<u>4,037,722</u>	<u>3,967,981</u>

Options to purchase 556,466 shares of common stock with exercise prices ranging from \$10.73 to \$12.00, with an average price of \$11.13, were outstanding at September 30, 2004 but were not included in the computation of diluted earnings per share for the three and nine months ended September 30, 2004 because the options' exercise price was greater than the average market price of the common shares for those periods. These options expire from 2010-2014.

COWLITZ BANCORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(amounts in thousands, except number of shares and per share amounts)

Options to purchase 275,066 shares of common stock with exercise prices ranging from \$7.91 to \$12.00, with an average price of \$11.09, were outstanding at September 30, 2003 but were not included in the computation of diluted earnings per share for the three and nine months ended September 30, 2003 because the options' exercise price was greater than the average market price of the common shares for those periods. These options expire from 2008-2013.

## 6. Recently Issued Accounting Standards

In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46("FIN 46R"), *Consolidation of Variable Interest Entities (revised December 2003)*. In December 2003, the FASB made revisions and delayed implementation of certain provisions of FIN 46R. FIN 46R provides guidance on how to identify the primary beneficiary of a variable interest entity ("VIE") and determine when the VIE should be consolidated by the primary beneficiary. The recognition and measurement provisions of FIN 46R, as revised, were adopted for the quarter ended March 31, 2004. The Company does not have any VIEs and, accordingly, the implementation of this Interpretation did not impact its consolidated financial statements or results of operations.

In March 2004, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 105 ("SAB 105"), *Application of Accounting Principles to Loan Commitments*. SAB 105 provides guidance on the accounting for loan commitments accounted for as derivative instruments. The Company adopted SAB 105 in March 2004. The adoption did not have a material impact on the Company's consolidated financial statements or results of operation.

In March 2004, the FASB ratified the consensus reached by the Emerging Issues Task Force regarding issue 03-1 *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* ("EITF 03-01"). The consensus provided guidance for determining when an investment is other-than-temporarily-impaired. The guidance was effective for periods beginning after June 15, 2004. On September 30, 2004, the FASB deferred the implementation of the recognition criteria of EITF 03-01 until the fourth quarter of 2004 pending a review of the guidance in light of comments received. The Company will evaluate the potential impact this guidance may have on its financial statements and results of operations when it is released in final form.

## 7. Stock-Based Compensation

SFAS No. 123, "Accounting for Stock-Based Compensation," requires disclosure about stock-based compensation arrangements regardless of the method used to account for them. As permitted by SFAS No. 123, the Company has decided to apply the accounting provisions of Accounting Principles Board (APB) Opinion No. 25, and therefore discloses the difference between compensation cost included in net income and the related cost measured by the fair value-based method defined by SFAS No. 123, including tax effects, that would have been recognized in the statement of income if the fair value method had been used. Under APB Opinion No. 25, no compensation cost has been recognized for the Company's stock option plans. Had compensation cost for these plans been determined consistent with SFAS No. 123 and recognized over the vesting period, the Company's net income and earnings per share would have been reduced to the following pro forma amounts:

	<u>Three Months Ended</u> <u>September 30, 2004</u>		<u>Three Months Ended</u> <u>September 30, 2003</u>		<u>Nine Months Ended</u> <u>September 30, 2004</u>		<u>Nine Months Ended</u> <u>September 30, 2003</u>	
	<u>As</u> <u>Reported</u>	<u>Pro</u> <u>Forma</u>	<u>As</u> <u>Reported</u>	<u>Pro</u> <u>Forma</u>	<u>As</u> <u>Reported</u>	<u>Pro</u> <u>Forma</u>	<u>As</u> <u>Reported</u>	<u>Pro</u> <u>Forma</u>
	(dollars in thousands, except for share amounts)							
Net income	<u>\$ 517</u>	<u>\$ 430</u>	<u>\$ 320</u>	<u>\$ 258</u>	<u>\$ 1,353</u>	<u>\$1,182</u>	<u>\$ 1,248</u>	<u>\$ 977</u>
Basic earnings per share	<u>\$ 0.13</u>	<u>\$ 0.11</u>	<u>\$ 0.08</u>	<u>\$ 0.07</u>	<u>\$ 0.34</u>	<u>\$ 0.30</u>	<u>\$ 0.32</u>	<u>\$ 0.25</u>
Diluted earnings per share	<u>\$ 0.13</u>	<u>\$ 0.10</u>	<u>\$ 0.08</u>	<u>\$ 0.06</u>	<u>\$ 0.34</u>	<u>\$ 0.29</u>	<u>\$ 0.31</u>	<u>\$ 0.25</u>



COWLITZ BANCORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(amounts in thousands, except number of shares and per share amounts)

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for the periods ended September 30, 2004 and 2003.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Dividend yield	0.00%	0.00%	0.00%	0.00%
Expected life (years)	4.26	4.17	4.26	4.17
Expected volatility	35.81%	49.39%	35.81% - 38.40%	49.39% - 52.11%
Risk-free rate	2.78%	2.87%	2.78% - 2.98%	2.87% - 2.98%

## 8. Comprehensive Income

For the Company, comprehensive income primarily includes net income reported on the statements of income and changes in the fair value of available-for-sale investment securities. These amounts are included in "Other Comprehensive Income" on the consolidated statement of changes in shareholders' equity. In March 2004, the Company transferred \$8.0 million of investment securities previously classified as "held-to-maturity" to "available-for-sale" classification. As a result of this re-classification, an unrealized loss of \$853,000, net of deferred taxes of \$436,000, was recognized in comprehensive income and a component of other comprehensive income for the nine months ended September 30, 2004.

## 9. Segments of an Enterprise and Related Information

The Company is principally engaged in community banking activities through its branches and corporate offices. Community banking activities include accepting deposits, providing loans and lines of credit to local individuals, businesses and governmental entities, investing in investment securities and money market instruments, and holding or managing assets in a fiduciary agency capacity on behalf of its customers and their beneficiaries. The mortgage banking segment, Bay Mortgage, offers a full line of residential lending products including FHA and VA loans, construction loans, and bridge loans.

The community banking and mortgage banking activities are monitored and reported by Company management as separate operating segments. Despite the closure of Bay Escrow and the Bellevue and Seattle offices of Bay Mortgage during the fourth quarter of 2003, mortgage lending activities in the remaining locations will continue to be reported as a separate operating segment.

The accounting policies for the Company's segment information provided in the following tables are the same as those described for the Company in the summary of significant accounting policies footnote included in the Company's 2003 annual report, except that some operating expenses and the results of discontinued operations are not allocated to segments.

COWLITZ BANCORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(amounts in thousands, except number of shares and per share amounts)

Summarized financial information for the three and nine months ended September 30, 2004 and 2003, concerning the Company's reportable segments is shown in the following tables:

	Three Months Ended September 30, 2004				
	<u>Banking</u>	<u>Mortgage Banking</u>	<u>Holding Company</u>	<u>Intersegment</u>	<u>Consolidated</u>
Interest income	\$ 4,311	\$ 7	\$ 1	\$ (496)	\$ 3,823
Interest expense	<u>1,201</u>	<u>10</u>	<u>12</u>	<u>(496)</u>	<u>727</u>
Net interest income (expense)	3,110	(3)	(11)	-	3,096
Provision (benefit) for loan losses	100	-	(27)	-	73
Non-interest income	567	68	-	-	635
Non-interest expense	<u>2,721</u>	<u>153</u>	<u>96</u>	<u>-</u>	<u>2,970</u>
Income (loss) before provision (benefit) for income taxes	856	(88)	(80)	-	688
Provision (benefit) for income taxes	<u>223</u>	<u>(30)</u>	<u>(22)</u>	<u>-</u>	<u>171</u>
Net income (loss)	<u>\$ 633</u>	<u>\$ (58)</u>	<u>\$ (58)</u>	<u>\$ -</u>	<u>\$ 517</u>
Depreciation and amortization	<u>\$ 142</u>	<u>\$ 12</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 154</u>

  

	Three Months Ended September 30, 2003				
	<u>Banking</u>	<u>Mortgage Banking</u>	<u>Holding Company</u>	<u>Intersegment</u>	<u>Consolidated</u>
Interest income	\$ 3,594	\$ 543	\$ 3	\$ (354)	\$ 3,786
Interest expense	<u>1,110</u>	<u>313</u>	<u>56</u>	<u>(354)</u>	<u>1,125</u>
Net interest income (expense)	2,484	230	(53)	-	2,661
Provision (benefit) for loan losses	126	-	(162)	-	(36)
Non-interest income	473	1,696	6	-	2,175
Non-interest expense	<u>2,709</u>	<u>1,635</u>	<u>61</u>	<u>-</u>	<u>4,405</u>
Income before provision for income taxes	122	291	54	-	467
Provision for income taxes	<u>27</u>	<u>100</u>	<u>20</u>	<u>-</u>	<u>147</u>
Net income	<u>\$ 95</u>	<u>\$ 191</u>	<u>\$ 34</u>	<u>\$ -</u>	<u>\$ 320</u>
Depreciation and amortization	<u>\$ 158</u>	<u>\$ 29</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 187</u>

COWLITZ BANCORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(amounts in thousands, except number of shares and per share amounts)

	<u>Nine Months Ended September 30, 2004</u>				
	<u>Banking</u>	<u>Mortgage Banking</u>	<u>Holding Company</u>	<u>Intersegment</u>	<u>Consolidated</u>
Interest income	\$ 12,466	\$ 136	\$ 6	\$ (1,481)	\$ 11,127
Interest expense	<u>3,479</u>	<u>123</u>	<u>96</u>	<u>(1,481)</u>	<u>2,217</u>
Net interest income (expense)	8,987	13	(90)	-	8,910
Provision (benefit) for loan losses	350	-	(190)	-	160
Non-interest income	1,702	463	-	-	2,165
Non-interest expense	<u>7,903</u>	<u>882</u>	<u>375</u>	<u>-</u>	<u>9,160</u>
Income (loss) before provision (benefit) for income taxes	2,436	(406)	(275)	-	1,755
Provision (benefit) for income taxes	<u>630</u>	<u>(140)</u>	<u>(88)</u>	<u>-</u>	<u>402</u>
Net income (loss)	<u>\$ 1,806</u>	<u>\$ (266)</u>	<u>\$ (187)</u>	<u>\$ -</u>	<u>\$ 1,353</u>
Depreciation and amortization	<u>\$ 460</u>	<u>\$ 44</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 504</u>
Total assets	<u>\$ 267,803</u>	<u>\$ 103</u>	<u>\$ 35,212</u>	<u>\$ (34,679)</u>	<u>\$ 268,439</u>

COWLITZ BANCORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(amounts in thousands, except number of shares and per share amounts)

	Nine Months Ended September 30, 2003				
	Banking	Mortgage Banking	Holding Company	Intersegment	Consolidated
Interest income	\$ 11,672	\$ 2,239	\$ 18	\$ (1,333)	\$ 12,596
Interest expense	<u>3,969</u>	<u>1,204</u>	<u>169</u>	<u>(1,333)</u>	<u>4,009</u>
Net interest income (expense)	7,703	1,035	(151)	-	8,587
(Benefit) provision for loan losses	(526)	-	1,056	-	530
Non-interest income	1,533	6,840	6	-	8,379
Non-interest expense	<u>8,203</u>	<u>6,068</u>	<u>258</u>	<u>-</u>	<u>14,529</u>
Income (loss) before provision (benefit) for income taxes	1,559	1,807	(1,459)	-	1,907
Provision (benefit) for income taxes	<u>533</u>	<u>623</u>	<u>(497)</u>	<u>-</u>	<u>659</u>
Net income (loss)	<u>\$ 1,026</u>	<u>\$ 1,184</u>	<u>\$ (962)</u>	<u>\$ -</u>	<u>\$ 1,248</u>
Depreciation and amortization	<u>\$ 520</u>	<u>\$ 84</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 604</u>
Total assets	<u>\$ 269,432</u>	<u>\$ 22,457</u>	<u>\$ 35,568</u>	<u>\$ (53,883)</u>	<u>\$ 273,574</u>

Compared to segment information reported during the three and nine months ended September 30, 2003, the mortgage banking segment experienced significantly lower activity during the corresponding periods of 2004. In December 2003 and the first quarter of 2004, the Company reduced the size of its mortgage banking operations by closing its Bay Mortgage offices in Bellevue and Seattle. Management believes that the net losses reported for the mortgage banking segment during 2004 could have been significantly higher if the segment had continued to operate as it had during 2003. Reduced demand for mortgage refinance loans and a desire to concentrate resources on the core banking segment were significant factors leading to the decision to scale back the mortgage banking segment.

The credit to the provision for loan losses reported during the three and nine months ended September 30, 2004 and the three months ended September 30, 2003 in the holding company segment were generated from recoveries of previously charged-off loans in a segment that no longer carries a loan portfolio.

The segment information for the nine months ended September 30, 2003 includes a reclassification between the banking and holding company segments of \$901,000 for the provision for loan losses. This reclassification does not affect the consolidated results of operation or earnings per share, but has resulted in a benefit to the banking segment presented above.

Although mortgage operations have been significantly reduced, and have generated small losses during 2004, improved efficiencies and an increase in net interest income in the banking segment more than offset the losses. Excluding the provision reclassification discussed above, the banking segment reported net income of approximately \$431,000 during the first nine months of 2003, compared to \$1.8 million during the same period of 2004, an increase of about \$1.4 million. The efficiency ratio (non-interest expense divided by the sum of non-interest income and net interest income) for the banking segment has improved significantly to 74.0% and 73.9% for the three and nine months ended September 30, 2004, respectively, from 91.6% and 88.8% for the same periods of 2003, respectively.

## **Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Results of Operations for the Three and Nine Months Ended September 30, 2004 and 2003**

The Company's net income for the third quarter of 2004 was \$517,000, or \$0.13 per diluted share, compared to net income of \$320,000, or \$0.08 per diluted share for the third quarter of 2003. Net income for the nine months ended September 30, 2004 and 2003 was \$1.4 million, or \$0.34 per diluted share, and \$1.2 million or \$0.31 per diluted share, respectively. Net interest income was \$3.1 million or 14.8% higher during the three months ended September 30, 2004 compared to \$2.7 million during the same period of 2003. During the third quarter of 2004, the banking segment recorded a \$100,000 provision for loan losses, which was offset by a credit to the provision for loan losses of \$27,000 resulting from a recovery by the holding company of a previously charged-off loan. Similarly, the components of the year to date provision for 2004 of \$160,000 include a provision by the banking segment of \$350,000 offset by recoveries by the holding company of \$190,000. The provision recorded during the first nine months of 2003 was higher based on management's assessment of the adequacy of the allowance for loan losses at that time. Non-interest income and non-interest expenses are lower in the current periods when compared to 2003, primarily from reductions in the Company's mortgage operations and initiatives implemented that target expense reductions.

### **Financial Condition as of September 30, 2004 and December 31, 2003**

At September 30, 2004, total assets were \$268.4 million, virtually unchanged from \$268.8 million at December 31, 2003. Total liabilities were \$233.3 million at September 30, 2004, a decline of \$3.7 million or 1.6% from \$237.0 million at December 31, 2003.

Although total assets have declined only slightly from the December 31, 2003 level, the mix of assets has changed substantially. At December 31, 2003, the balance of loans held-for-sale was \$8.4 million but as of March 31, 2004, the entire balance had been sold into the secondary market. As part of the strategy to curtail mortgage operations, the Company will no longer originate loans for sale into the secondary market. Although the Company has ceased its secondary market function and closed its Bay Mortgage offices in Bellevue and Seattle, Washington, mortgage lending products will continue to be offered to the Company's customers in its remaining Bay Mortgage locations in Longview and Vancouver, Washington. Loans, net of deferred fees, have increased \$23.2 million since December 31, 2003 to \$186.7 million at September 30, 2004. Approximately \$16.5 million of this increase has occurred during the third quarter. The increase in loans was offset primarily by a reduction of \$17.6 million in cash and cash equivalents from December 31, 2003 to September 30, 2004. Total investment securities have increased approximately \$4.0 million during the first nine months of 2004. A reclassification of \$8.0 million of municipal bond investments from held-to-maturity to available-for-sale accounts for the large variance in the components of the Company's investment securities holdings.

The mix of liabilities at September 30, 2004 has also changed considerably since December 31, 2003. Total deposits have declined \$5.3 million during the first nine months of 2004, despite an increase of \$8.5 million in certificates of deposit. FHLB notes payable and other borrowings were \$7.8 million lower at September 30, 2004 than at December 31, 2003, but fed funds purchased were \$9.1 million higher. At September 30, 2004, the Company had \$26.0 million in brokered certificates of deposits or 11.8% of \$221.2 million in total deposits. This compares to \$10.4 million of brokered certificates of deposit at December 31, 2003 or 4.6% of \$226.5 million in total deposits.

### **Critical Accounting Policies**

The Company's most critical accounting policy is related to the allowance for loan losses. The Company utilizes both quantitative and qualitative considerations in establishing an allowance for loan losses believed to be appropriate as of each reporting date.

Quantitative factors include:

- the volume and severity of non-performing loans and adversely classified credits,
- the level of net charge-offs experienced on previously classified loans,
- the nature and value of collateral securing the loans,
- the trend in loan growth and the percentage of change,
- the level of geographic and/or industry concentration,
- the relationship and trend over the past several years of recoveries in relation to charge-offs, and
- other known factors regarding specific loans.

Qualitative factors include:

- the effectiveness of credit administration,
- the adequacy of loan review,
- the adequacy of loan operations personnel and processes,
- the effect of competitive issues that impact loan underwriting and structure,
- the impact of economic conditions, and
- the introduction of new loan products or specific marketing efforts.

Changes in the above factors could significantly effect the determination of the adequacy of the allowance for loan losses. Management performs a full analysis, no less often than quarterly, to ensure that changes in estimated loan loss levels are adjusted on a timely basis. For further discussion of this significant management estimate, see "Allowance for Loan Losses."

Another critical accounting policy for the Company is that related to the carrying value of goodwill. Goodwill was recognized as the excess of cost over the fair value of net assets acquired from the purchase of Bay Mortgage, and the Portland, Oregon branch of Bay Bank, formerly Northern Bank of Commerce. Goodwill was amortized using the straight-line method over a 15-year period until December 31, 2001. Effective January 1, 2002, pursuant to Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," the Bank ceased amortization of goodwill and completed its first of ongoing assessments of goodwill impairment in March 2002. The \$852,000 current balance of goodwill is related entirely to the Northern Bank of Commerce purchase. Goodwill impairment will be deemed to exist in the future if the net book value of a reporting unit, considered by the Bank to represent its operating segments, exceeds its estimated fair value.

### Analysis of Net Interest Income

The primary component of the Company's earnings is net interest income. Net interest income is the difference between interest income, principally from loans and the investment securities portfolio, and interest expense, principally on customer deposits and borrowings. Changes in net interest income, net interest spread, and net interest margin result from changes in asset and liability volume, mix, and changes to rates earned or paid. Net interest spread refers to the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities. Net interest margin is the ratio of net interest income to total interest-earning assets and is influenced by the volume and relative mix of interest-earning assets and interest-bearing liabilities. Volume refers to the dollar level of interest-earning assets and interest-bearing liabilities.

#### Three months ended September 30, 2004 and 2003

Interest income from certain of the Company's earning assets is non-taxable. The following tables present interest income and expense, including adjustments for non-taxable interest income, and the resulting tax adjusted yields earned, rates paid, interest rate spread, and net interest margin for the periods indicated.

(dollars in thousands)	Three Months Ended September 30,		Increase (Decrease)	Change
	2004	2003		
Interest income	\$ 3,823	\$ 3,786	\$ 37	1.0%
Tax effect of non-taxable interest income	44	20	24	120.0%
Tax equivalent interest income	3,867	3,806	61	1.6%
Interest expense	727	1,125	(398)	-35.4%
Net interest income	<u>\$ 3,140</u>	<u>\$ 2,681</u>	<u>\$ 459</u>	17.1%
Average interest-earning assets	\$ 243,739	\$ 262,643	\$ (18,904)	-7.2%
Average interest-bearing liabilities	\$ 174,425	\$ 199,714	\$ (25,289)	-12.7%
Average yields earned (1)	6.35%	5.80%	55 b.p. (3)	
Average rates paid (1)	1.67%	2.25%	(58) b.p. (3)	
Net interest spread (1)	4.68%	3.55%	113 b.p. (3)	
Net interest margin (1) (2)	5.15%	4.08%	107 b.p. (3)	

(1) Ratios for the three months ended September 30, 2004 and 2003 have been annualized

(2) Computed by dividing non-interest income by average interest-earning assets

(3) b.p. stands for "basis points" (100 b.p. is equal to 1.0%)

Comparing the quarter ended September 30, 2004 to the quarter ended September 30, 2003, tax equivalent interest income was \$61,000 higher, despite a decline in total interest-earning assets of \$18.9 million. Changes to both the asset mix and interest rates contributed to this result. During the third quarter of 2003, the balance of loans held-for-sale, which earned a lower yield than the general loan portfolio, averaged \$23.9 million. The Company no longer carries loans held-for-sale, consistent with the reorganization of the mortgage segment during late 2003 and early 2004. Loans (excluding loans held-for-sale) averaged \$168.8 million during the third quarter of 2003 compared to \$181.6 million during the same period of 2004. Other changes in asset mix when comparing the

periods include a reduction of \$28.4 million in average balances of low yield cash and cash equivalents, and an increase of \$25.2 million in relatively higher yielding investment securities.

Increases in interest rates, including the Company's prime lending rate, have also contributed to a higher yield earned on average interest-earning assets when comparing the third quarter of 2003 to the third quarter of 2004. The prime rate increased by 25 basis points two separate times during the third quarter of 2004 and is now 4.75% compared to 4.00% during the third quarter of 2003. Prime based loans, which account for approximately 40% of the overall loan portfolio, reprice immediately with changes to the prime rate.

Interest expense was \$398,000 lower during the third quarter of 2004 compared to the same period of 2003. Both the volume of interest-bearing liabilities and the rates paid on them declined comparing the two periods. The decline in average rates paid on interest-bearing liabilities is primarily attributable to the continued maturity of higher rate long-term certificates of deposit, which either did not renew or were re-priced at current, lower rates. Certificates of deposit averaged \$86.5 million during the third quarter of 2003, but declined to an average of \$81.2 million during the third quarter of 2004. The average rates paid on certificates of deposit were also approximately 70 basis points lower in 2004 when comparing the two quarters. The interest rates paid on other interest-bearing deposits were also slightly lower during the three months ended September 30, 2004 when compared to the three months ended September 30, 2003. In addition, the Company paid off a \$5.0 million FHLB note that was bearing an interest rate of 7.44% during the third quarter of 2003. The Company also paid off a note at the holding company with an average balance of \$1.9 million through August 2004 and an interest rate of 8.0%.

*Nine months ended September 30, 2004 and 2003*

(dollars in thousands)	Nine Months Ended September 30,		Increase (Decrease)	Change
	2004	2003		
Interest income	\$ 11,127	\$ 12,596	\$ (1,469)	-11.7%
Tax effect of non-taxable interest income	121	40	81	202.5%
Tax equivalent interest income	11,248	12,636	(1,388)	-11.0%
Interest expense	2,217	4,009	(1,792)	-44.7%
Net interest income	<u>\$ 9,031</u>	<u>\$ 8,627</u>	<u>\$ 404</u>	4.7%
Average interest-earning assets	\$ 239,432	\$ 282,090	\$ (42,658)	-15.1%
Average interest-bearing liabilities	\$ 172,653	\$ 219,975	\$ (47,322)	-21.5%
Average yields earned (1)	6.26%	5.97%	29 b.p. (3)	
Average rates paid (1)	1.71%	2.43%	(72) b.p. (3)	
Net interest spread (1)	4.55%	3.54%	101 b.p. (3)	
Net interest margin (1) (2)	5.03%	4.08%	95 b.p. (3)	

(1) Ratios for the nine months ended September 30, 2004 and 2003 have been annualized

(2) Computed by dividing non-interest income by average interest-earning assets

(3) b.p. stands for "basis points" (100 b.p. is equal to 1.0%)

Comparing the nine months ended September 30, 2004 to the nine months ended September 30, 2003, tax equivalent interest income was \$1.4 million lower, primarily due to a decline in average interest-earnings assets of \$42.7 million. Reductions in loans held-for-sale resulting from the mortgage segment realignment account for \$27.7 million of this decline. Interest bearing cash and cash equivalent balances are \$35.9 million lower comparing the two nine month periods. The average yields earned were higher during the first nine months of 2004 compared to the same period of 2003, despite a lower average prime rate during the 2004 period. The change in asset mix from lower rate cash accounts and loans held-for-sale into higher yielding investment securities and loans offset the overall lower rate environment.

Interest expense was \$1.8 million lower during the third quarter of 2004 compared to the same period of 2003. Both the volume of interest-bearing liabilities and the rates paid on them declined significantly comparing the two periods. The decline in average rates paid on interest-bearing liabilities is primarily attributable to the continued maturity of higher rate long-term certificates of deposit, which either did not renew or were re-priced at current, lower rates. Certificates of deposit averaged \$107.1 million during the first nine months of 2003, but declined to an average of \$79.8 million during the same period of 2004. Similar to the quarterly analysis above, the average rates paid on certificates of deposit were approximately 70 basis points lower comparing the nine month periods. The interest rates paid on other interest-bearing deposits were also slightly lower during the nine months ended September 30, 2004

when compared to the nine months ended September 30, 2003. In addition, the Company paid off a \$5.0 million FHLB note that was bearing an interest rate of 7.44% during the first nine months of 2003. The Company also paid off a note at the holding company with an average balance of \$1.9 million through August 2004 and an interest rate of 8.0%.

### Provision for Loan Losses

The amount of the allowance for loan losses is analyzed by management on a regular basis to ensure that it is adequate to absorb losses inherent in the loan portfolio as of the reporting date. When a provision for loan losses is recorded, the amount is based on past charge-off experience, a careful analysis of the current loan portfolio, the level of non-performing and impaired loans, evaluation of future economic trends in the Company's market area, and other factors relevant to the loan portfolio. The quarterly provision recorded as an increase to the allowance for loan losses is based upon estimates of probable losses inherent in the loan portfolio. The loss amount actually realized for these loans can vary significantly from the estimated amounts. See the "Allowance for Loan Losses" discussion for additional detail.

#### *Three and nine months ended September 30, 2004 and 2003*

The net provision for loan losses was \$73,000 for the quarter ended September 30, 2004 compared to a benefit of \$36,000 for the same period of 2003. For the first nine months of 2004, the provision was \$160,000 compared to \$530,000 for the same period of 2003. The provision recorded during 2004 is lower than during 2003 due to an overall strengthening in loan quality, and holding company recoveries discussed below.

During 2004 and 2003, the holding company received payments as recoveries of loans previously charged-off. Because the holding company does not currently have any loans or an allowance for loan losses, any recovery of previously charged-off amounts flow through the income statement as a credit, or benefit, to the provision expense. These benefits are recorded on the Company's consolidated statements of income net of loan loss provisions recorded during the periods. The banking segment recorded provisions for loan losses of \$100,000 and \$350,000 for the three and nine month periods ended September 30, 2004, respectively, compared to \$126,000 and \$375,000, net of a reclassification adjustment with the holding company, for the corresponding periods of 2003, respectively.

### Non-Interest Income

#### *Three and nine months ended September 30, 2004 and 2003*

Non-interest income consists of the following components:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
(dollars in thousands)				
Service charge on deposit accounts	\$ 174	\$ 211	\$ 535	\$ 695
(Losses) gains on loans sold	(17)	1,110	122	4,106
Mortgage brokerage fees	73	336	327	1,830
Escrow fees	-	244	-	905
Credit card income	159	175	436	471
Fiduciary income	104	70	302	240
Increase in cash surrender value of bank-owned life insurance	96	74	332	74
ATM income	15	13	42	39
Safe deposit box fees	1	-	26	27
Gain on sale of available-for-sale securities	8	-	8	-
Gain (loss) on sale of repossessed assets	6	(87)	(9)	(50)
Other miscellaneous fees and income	16	29	44	42
Total non-interest income	<u>\$ 635</u>	<u>\$ 2,175</u>	<u>\$ 2,165</u>	<u>\$ 8,379</u>

Total non-interest income has declined substantially when comparing the three and nine month periods ended September 30, 2004 to the same periods of 2003. Reductions in non-interest income generated by the mortgage banking segment due to the reorganization of that segment is the primary factor. Gains on loans sold and escrow fees will no longer be generated under the current structure, and mortgage brokerage fees will be significantly lower than in past periods. The loss on loans sold of \$17,000 recognized during the third quarter of 2004 was the result of repurchased loans previously sold into the secondary market. The purchasers of these loans have the ability to sell the loan back to the Company and recover the premiums they paid to the Company for loans purchased if the borrower re-finances the loan within 90 days after it is acquired, or if the borrower becomes delinquent.



## Non-Interest Expense

Three and nine months ended September 30, 2004 and 2003

Non-interest expense consists of the following components:

(dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Salaries and employee benefits	\$ 1,499	\$ 2,208	\$ 4,732	\$ 7,297
Net occupancy and equipment expense	353	566	1,165	1,778
Professional fees	187	329	528	1,275
Business taxes	69	79	173	310
FDIC insurance assessment	8	119	215	390
Credit card expense	154	163	420	469
Data processing and communications	73	126	227	363
Loan expense	-	116	27	469
Postage and freight	55	104	176	335
Travel and education	45	65	125	202
Stationery and supplies	29	54	96	169
Temporary help	53	45	59	338
Amortization of intangible assets	66	66	199	199
Expenses relating to other real estate owned	29	46	71	147
Advertising	45	47	97	103
Other miscellaneous expenses	305	272	850	685
Total non-interest expense	<u>\$ 2,970</u>	<u>\$ 4,405</u>	<u>\$ 9,160</u>	<u>\$ 14,529</u>

Consistent with non-interest income discussed above, the majority of the decline in total non-interest expense is attributable to the reorganization of the Company's mortgage segment during the fourth quarter of 2003. Salaries and employee benefits, net occupancy and equipment, professional fees, business taxes, data processing and communications, postage and freight, stationery and supplies, and temporary help are all lower in part because of the closure of the Bellevue and Seattle mortgage offices and the cessation of the mortgage loan secondary marketing function.

At September 30, 2004, the Company had 105 full-time equivalent employees compared to 172 at September 30, 2003. The mortgage segment reorganization decreased the full-time equivalent employee count by 67 when comparing the two periods. Also included in salary expenses are ordinary annual wage increases for many existing employees.

Net occupancy and equipment expenses consist of depreciation on premises and equipment, lease costs, parking, maintenance and repair expenses, utilities and related expenses. During the second quarter, the Company entered into a new lease agreement at one of its banking branches that has decreased occupancy expenses by approximately \$5,000 per month.

Professional fees include exam and audit expenses, accounting, consulting and legal fees, and other professional fees. These expenses were significantly lower during the three and nine month periods ended September 30, 2004 compared to the same periods of 2003. Legal and consulting fees were higher during 2003 as the Company sought advice and opinions regarding contracts, regulatory documentation, establishing or improving internal controls to improve regulatory reporting, collection and repossession of loans, and various other administrative issues. Also included during the first quarter 2003 was approximately \$79,000 in professional fees associated with a State of Washington Department of Financial Institutions examination conducted in 2002.

Business taxes are based on adjusted revenues, and the expense has declined when comparing the third quarter and first nine months of 2004 to the same periods of 2003 as overall revenues, specifically from the mortgage segment, have declined.

The FDIC insurance premium rate for the bank was reduced to zero during the third quarter of 2004 compared to \$0.17 per \$100 of domestic deposits for all other periods presented. The FDIC sets deposit insurance premiums based upon the risks a particular bank or savings association poses to the deposit insurance funds. This system bases an institution's risk category partly upon whether the institution is well capitalized, adequately capitalized or less than adequately capitalized. Each insured depository institution is also assigned to one of three "supervisory" categories based on reviews by regulators, statistical analysis of financial statements and other relevant information. An institution's assessment rate depends upon the capital category and supervisory category to which it is assigned. Annual assessment rates currently range from zero per \$100 of domestic deposits for the highest rated institution to \$0.27

per \$100 of domestic deposits for an institution in the lowest category. Under legislation enacted in 1996 to recapitalize the Savings Association Insurance Fund, the FDIC is authorized to collect assessments against insured deposits to be paid to the Financing Corporation ("FICO") to service FICO debt incurred in the 1980's. The current FICO assessment rate for insured deposits is \$0.0148 per \$100 of deposits per year. Any increase in deposit insurance premiums or FICO assessments could have an adverse effect on Cowlitz Bank's earnings.

Loan expenses have declined significantly during the three and nine months ended September 30, 2004 compared to the same periods of 2003. Approximately \$130,000 of expense was recognized during 2003 to write-off prepaid mortgage expenses. These expenses, including appraisals and credit reports, were prepaid on behalf of potential borrowers when they applied for a mortgage loan. In some cases, these expenses were not collected from the borrower at the close of the loan, or the loan never closed. This amount was determined to be the potential charge to expense pending additional review of each individual loan account. Included in third quarter 2004 loan expenses, as this analysis was concluded, is a recovery of \$20,000 of previously written-off prepaid mortgage expenses. The remaining decline in expenses during 2004 when compared to 2003 is attributable to the mortgage segment realignment, and resulting lower volume of mortgage loans processed.

Temporary help expenses have increased during the third quarter 2004 as additional temporary audit staff has been retained to assist in the implementation of a Company wide, extensive audit plan. The plan includes the audit and documentation of financial reporting processes and procedures as required by public companies under the Sarbanes-Oxley legislation.

## Income Taxes

### *Three and nine months ended September 30, 2004 and 2003*

During the third quarter of 2004 the provision for income taxes was \$171,000 compared to \$147,000 for the third quarter of 2003. These provisions resulted in an effective tax rate of 24.9% and 31.5% for the quarters ended September 30, 2004 and 2003, respectively. During the nine months ended September 30, 2004, the provision was \$402,000 and the effective rate was 22.9% compared to \$659,000 and 34.6% for the same period of 2003. Non-taxable income generated from increased investment in non-taxable municipal bonds and from the \$8.0 million of bank-owned life insurance resulted in the reduced effective tax rate for the third quarter and first nine months of 2004.

## Loans

Total loans outstanding were \$186.7 million and \$163.5 million at September 30, 2004 and December 31, 2003, respectively. Unfunded loan commitments such as home equity and other lines of credit, unused available credit on credit cards, and letters of credit, were \$40.3 million at September 30, 2004 and \$42.4 million at December 31, 2003.

The following table presents the composition of the Company's loan portfolio at the dates indicated:

(dollars in thousands)	September 30, 2004		December 31, 2003	
	Amount	Percent	Amount	Percent
Commercial	\$ 55,536	29.67%	\$ 38,793	23.63%
Real estate construction	24,804	13.25%	18,305	11.15%
Real estate commercial	75,550	40.38%	77,412	47.17%
Real estate mortgage	28,363	15.15%	25,530	15.55%
Consumer and other	2,907	1.55%	4,103	2.50%
	<u>187,160</u>	<u>100.00%</u>	<u>164,143</u>	<u>100.00%</u>
Deferred loan fees	<u>(468)</u>		<u>(653)</u>	
Total loans	186,692		163,490	
Allowance for loan losses	<u>(3,942)</u>		<u>(3,968)</u>	
Total loan, net	<u>\$ 182,750</u>		<u>\$ 159,522</u>	

## Allowance for Loan Losses

The allowance for loan losses represents management's estimate of potential losses as of the date of the financial statements. The loan portfolio is regularly reviewed to evaluate the adequacy of the allowance for loan losses. In determining the level of the allowance, the Company evaluates the amount necessary for specific non-performing loans and estimates losses inherent in other loans. An important element in determining the adequacy of the allowance for loan losses is an analysis of loans by loan risk-rating categories. At a loan's inception, management evaluates the credit risk by using a risk-rating system. This grading system currently includes eleven levels of risk. Risk ratings range from "1" for the strongest credits to "10" for the weakest. A "10" rated loan would normally represent a loss. All loans rated 7-10 are collectively the Company's "Watch List". The specific grades from 7-10 are "watch list" (risk-rating 7), "special mention" (risk-rating 7.5), "substandard" (risk-rating 8), "doubtful" (risk-rating 9), and "loss" (risk-rating 10).

When indicators such as operating losses, collateral impairment or delinquency problems show that a credit may have weakened, the credit will be downgraded as appropriate. Similarly, as borrowers bring loans current, show improved cash flows, or improve the collateral position of a loan, the credits may be upgraded. Management reviews all credits periodically for changes in such factors. The result is an allowance with four components, specific allowance, general allowance, special allowance, and an unallocated allowance.

*Specific Allowance.* Loans on the Company's Watch List, as described above, are specifically reviewed and analyzed. Management considers in its analysis expected future cash flows, the value of collateral and other factors that may impact the borrower's ability to pay. When significant conditions or circumstances exist on an individual loan indicating greater risk, specific reserves may be allocated in addition to the general reserve percentage for that particular risk-rating.

*General Allowance.* All loans are risk-rated 1 to 10. Those that do not require a specific allocation are subject to a general allocation based upon historic loss factors. Management determines these factors by analyzing the volume and mix of the existing loan portfolio, in addition to other factors. Management also analyzes the following:

- the volume and severity of non-performing loans and adversely classified credits;
- the level of net charge-offs experienced on previously classified loans;
- the nature and value of collateral securing the loans; and
- the relationship and trend over the past several years of recoveries in relation to charge-offs.

*Special Allowance.* From time to time, special reserves will be established to facilitate a change in the Bank's strategy and other factors. Special allocations are to take into consideration various factors that include, but are not limited to:

- Effectiveness of credit administration;
- Adequacy of loan review;
- Loan operations;
- The trend in loan growth and the percentage of change;
- Concentrations both geographic and industry;
- Competitive issues that impact loan underwriting/structure;
- Economic conditions; and
- Any special marketing or introduction of various loan products.

*Unallocated Allowance.* Management also attempts to ensure that the overall allowance appropriately reflects a margin for the imprecision necessarily inherent in estimates of expected loan losses.

The quarterly analysis of specific, general, and special allocations of the allowance is the principal method relied upon by management to ensure that changes in estimated loan loss levels are adjusted on a timely basis. The inclusion of historical loss factors in the process of determining the general component of the allowance also acts as a self-correcting mechanism of management's estimation process, as loss experience more remote in time is replaced by more recent experience. In its analysis of the specific, the general, and special allocations of the allowance, management also considers regulatory guidance in addition to the Company's own experience.

Loans and other extensions of credit deemed uncollectable are charged to the allowance. Subsequent recoveries, if any, are credited to the allowance. Actual losses may vary from current estimates and the amount of the provision may be either greater than or less than actual net charge-offs when and if they occur. The related provision for loan losses that is charged to income is the amount necessary to adjust the allowance to the level determined through the above process.

Management's evaluation of the loan portfolio resulted in total allowances for loan losses of \$3.9 million at September 30, 2004 compared to \$4.0 million at December 31, 2003. The allowance, as a percentage of total loans, declined from 2.43% at December 31, 2003 to 2.11% at September 30, 2004. Management believes the allowance for loan losses at both September 30, 2004 and December 31, 2003 is adequate to absorb current potential or anticipated losses.

The following table shows the components of the allowance for loan loss for the periods indicated:

(dollars in thousands)	September 30, 2004		December 31, 2003	
	Amount	Percent	Amount	Percent
General	\$ 2,098	53.21%	\$ 2,362	59.53%
Specific	46	1.17%	456	11.49%
Special	1,715	43.51%	709	17.87%
Unallocated	83	2.11%	441	11.11%
	<u>\$ 3,942</u>	<u>100.00%</u>	<u>\$ 3,968</u>	<u>100.00%</u>

The specific portion of the allowance has declined during the first nine months of 2004. Based on Management's assessment of the watch list loans, a lower volume of loans require specific reserves. The special reserves have increased from December 31, 2003 to September 30, 2004 based upon a more in-depth analysis of potential risk factors related to the current interest rate environment in the local economy. Management believes the local economic recovery, excluding new housing construction segments, is substantially behind the national trend. Coupled with the anticipation of an increasing interest rate environment, additional special reserves have been allocated against potential cash flow strains of the Company's borrowers.

The allowance for loan losses is based upon estimates of probable losses inherent in the loan portfolio. The amount actually observed for these losses can vary significantly from the estimated amounts. The following table shows the Company's loan loss performance for the periods indicated.

(dollars in thousands)	Nine Months Ended September 30,		Year Ended December 31,
	2004	2003	2003
Loans outstanding at end of period, net of deferred fees (1)	\$ 186,692	\$ 167,307	\$ 163,490
Average loans outstanding during the period (1)	\$ 172,314	\$ 176,470	\$ 173,966
Allowance for loan losses, beginning of period	\$ 3,968	\$ 6,150	\$ 6,150
Loans charged off:			
Commercial	126	818	1,409
Real Estate	180	488	1,671
Consumer	36	71	83
Credit Cards	82	30	61
Total loans charged-off	<u>424</u>	<u>1,407</u>	<u>3,224</u>
Recoveries:			
Commercial	198	84	504
Real Estate	28	205	237
Consumer	6	52	56
Credit Cards	6	7	8
Total recoveries	<u>238</u>	<u>348</u>	<u>805</u>
Provision for loan losses	<u>160</u>	<u>530</u>	<u>237</u>
Allowance for loan losses, end of period	<u>\$ 3,942</u>	<u>\$ 5,621</u>	<u>\$ 3,968</u>
Net loans charged-off during the period	186	1,059	2,419
Ratio of net loans charged-off to average loans outstanding	0.11%	0.60%	1.39%
Ratio of allowance for loan losses to loans at end of period	2.11%	3.36%	2.43%

(1) Excludes loans held-for-sale

### Impaired Loans

The Company, during its normal loan review procedures, considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loan is not considered to be impaired during a period of minimal delay (less than 90 days) unless available information strongly suggests impairment. The Company measures impaired loans based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as

a practical expedient, at the loan's observable market price or the fair market value of the collateral if the loan is collateral dependent. Impaired loans are charged to the allowance when management believes that, after considering economic and business conditions, collection efforts, and collateral position, the borrower's financial condition indicates that collection of principal is not probable.

Generally, no interest is accrued on loans when factors indicate collection of interest is doubtful or when principal or interest payments become 90 days past due, unless collection of principal and interest are anticipated within a reasonable period of time and the loans are well secured. For such loans, previously accrued but uncollected interest is charged against current earnings, and income is only recognized to the extent payments are subsequently received and collection of the remaining recorded principal balance is considered probable.

### Non-Performing Assets

Non-performing loans include all loans greater than 90 days past due with respect to either principal or interest, and all loans to which the accrual of interest has been suspended. These loans, combined with repossessed real estate and other repossessed assets, are collectively considered to be non-performing assets. The following table presents information on all non-performing assets:

(dollars in thousands)	September 30, 2004	December 31, 2003
Loans on non-accrual status	\$ 572	\$ 1,856
Loans past due greater than 90 days but not on non-accrual status	-	17
Other real estate owned	805	1,352
Other repossessed assets	-	-
Total non-performing assets	<u>\$ 1,377</u>	<u>\$ 3,225</u>
Total assets	<u>\$ 268,439</u>	<u>\$ 268,799</u>
Percentage of non-performing assets to total assets	<u>0.51%</u>	<u>1.20%</u>

The reduction of \$1.8 million since December 31, 2003 is due to a concerted effort by management to minimize the level of non-performing assets. While it may be difficult to maintain a ratio of non-performing assets to total assets at the current level, Management expects to keep the level below the trend experienced during 2003.

During the first nine months of 2004, 13 properties were sold or had a reduction in their carrying value resulting in an approximate \$1.0 million decline in the balance of other real estate owned. During the same time period of 2004, \$490,000 of properties were repossessed and added to the carrying value of other real estate owned.

### Liquidity

Liquidity represents the ability to meet deposit withdrawals and fund loan demand, while retaining the flexibility to take advantage of business opportunities. The Company's primary sources of funds have been customer and brokered deposits, loan payments, sales or maturities of investments, sales of loans or other assets, borrowings, and the use of the federal funds market.

Brokered certificates of deposit are a funding source the Company utilizes to provide additional liquidity as necessary. At September 30, 2004, the Company's broker certificate of deposit balance was \$26.0 million compared to \$10.4 million at December 31, 2003. Overnight federal funds borrowing lines with correspondent banks provide access to an additional \$24.5 million for short-term liquidity needs. In addition, the Company has an established borrowing line with the FHLB that permits it to borrow up to 20% of the Bank's assets, subject to collateral limitations. The line is available for overnight federal funds, or notes with other terms and maturities. At September 30, 2004, notes payable to the FHLB were \$518,000 compared to \$5.7 million at December 31, 2003. The notes payable at September 30, 2004 have original maturity periods ranging from 10 years through 15 years, bear interest at rates ranging from 6.11% to 8.62%, and mature from 2005 to 2009.

In order to maintain the ability to access cash through sale of securities, during the first quarter of 2004, \$8.0 million of held-to-maturity investments were reclassified as available-for-sale. Accordingly, the fair value of these investment securities was recognized within accumulated other comprehensive income upon their reclassification. Investment securities available-for-sale were \$58.8 million at September 30, 2004 compared to \$47.0 million at December 31, 2003.

### Regulatory Capital

The Company and the Bank are subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on Cowlitz Bancorporation's and Cowlitz Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Cowlitz Bancorporation

and Cowlitz Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Cowlitz Bancorporation's and Cowlitz Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The following table presents selected capital information for the Company and the Bank as of September 30, 2004 and December 31, 2003:

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>September 30, 2004</b>						
Total risk-based capital:						
Consolidated	\$ 36,321	17.22%	\$ 16,875	≥8.00%	N/A	N/A
Bank	\$ 35,534	16.89%	\$ 16,832	≥8.00%	\$ 21,040	≥10.00%
Tier 1 risk-based capital:						
Consolidated	\$ 33,668	15.96%	\$ 8,438	≥4.00%	N/A	N/A
Bank	\$ 32,888	15.63%	\$ 8,416	≥4.00%	\$ 12,624	≥6.00%
Tier 1 (leverage) capital:						
Consolidated	\$ 33,668	12.72%	\$ 10,584	≥4.00%	N/A	N/A
Bank	\$ 32,888	12.43%	\$ 10,579	≥4.00%	\$ 13,224	≥5.00%
<b>December 31, 2003</b>						
Total risk-based capital:						
Consolidated	\$ 32,679	16.38%	\$ 15,962	≥8.00%	N/A	N/A
Bank	\$ 33,614	16.85%	\$ 15,956	≥8.00%	\$ 19,946	≥10.00%
Tier 1 risk-based capital:						
Consolidated	\$ 30,166	15.12%	\$ 7,981	≥4.00%	N/A	N/A
Bank	\$ 31,102	15.59%	\$ 7,978	≥4.00%	\$ 11,967	≥6.00%
Tier 1 (leverage) capital:						
Consolidated	\$ 30,166	11.39%	\$ 10,597	≥4.00%	N/A	N/A
Bank	\$ 31,102	11.75%	\$ 10,591	≥4.00%	\$ 13,239	≥5.00%

Quantitative measures established by regulation to ensure capital adequacy require Cowlitz Bancorporation and Cowlitz Bank to maintain minimum amounts and ratios (set forth in the tables above) of Tier 1 capital to average assets, and Tier 1 and total risk-based capital to risk-weighted assets (all as defined in the regulations). Management believes that as of September 30, 2004 and December 31, 2003, Cowlitz Bancorporation and Cowlitz Bank substantially exceeded all relevant capital adequacy requirements.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

#### Credit Risk

The Company, like other lenders, is subject to credit risk, which is the risk of losing principal and interest due to customers' failure to repay loans in accordance with their terms. Although the Company has established lending criteria and an adequate allowance for loan losses to help mitigate credit risk, a downturn in economic conditions or in the real estate market, or a rapid increase in interest rates could have a negative effect on collateral values, cash flows, and borrowers' ability to repay. The Company's targeted customers are small to medium-size businesses, professionals and retail customers that may have limited capital resources to repay loans during a prolonged economic downturn.

#### Interest Rate Risk

The Company's earnings are largely derived from net interest income, which is interest income and fees earned on loans and investment income, less interest expense paid on deposits and other borrowings. Interest rates are highly sensitive to many factors that are beyond the control of the Company's management, including general economic conditions, and the policies of various governmental and regulatory authorities. As interest rates change, net interest income is affected. With fixed rate assets (such as fixed

rate loans) and liabilities (such as certificates of deposit), the effect on net interest income depends on the maturities of the assets and liabilities. The Company's primary objective in managing interest rate risk is to minimize the adverse impact of changes in interest rates on the Company's net interest income and capital, while structuring the Company's asset/liability position to obtain the maximum yield-cost spread on that structure. Interest rate risk is managed through the monitoring of the Company's gap position and sensitivity to interest rate risk by subjecting the Company's balance sheet to hypothetical interest rate shocks using a computer based model. In a falling rate environment, the spread between interest yields earned and interest rates paid, may narrow, depending on the relative level of fixed and variable rate assets and liabilities. In a stable or increasing rate environment the Company's variable rate loans will remain steady or increase immediately with changes in interest rates, while fixed rate liabilities, particularly certificates of deposit will only re-price as the liability matures.

#### **Item 4. Controls and Procedures**

As of September 30, 2004, the Company evaluated, under the supervision and the participation of Management, including the Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of disclosure controls and procedures. Based on that evaluation, Management, including the Chief Executive Officer and Chief Financial Officer, concluded that disclosure controls and procedures were effective.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation.

### **Part II. OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

The Company from time to time enters into routine litigation resulting from the collection of secured and unsecured indebtedness as part of its business of providing financial services. In some cases, such litigation will involve counterclaims or other claims against the Company. Such proceedings against financial institutions sometimes also involve claims for punitive damages in addition to other specific relief. The Company is not a party to any litigation other than in the ordinary course of business. In the opinion of management, the ultimate outcome of all pending legal proceedings will not individually or in the aggregate have a material adverse effect on the financial condition or the results of operations of the Company.

#### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Not applicable

#### **Item 3. Defaults upon Senior Securities**

Not applicable

#### **Item 4. Submission of Matters to a Vote of Security Holders**

Not applicable

#### **Item 5. Other Information**

Not applicable

#### **Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits. The following constitutes the exhibit index.

- 3.1\* Restated and Amended Articles of Incorporation of Registrant
- 3.2\* Bylaws of Registrant
- 31.1 Certification of Chief Executive Officer
- 31.2 Certification Chief Financial Officer
- 32 Certification of Chief Executive Officer and Chief Financial Officer

\* Incorporated by reference from Registration Statement on Form S-1, Reg. No. 333-44355

(b) During the quarter ended September 30, 2004, the Company furnished information under Item 12 of Form 8-K on July 30, 2004. The Company also reported the appointment of two directors under Item 5.02 of Form 8-K on September 27, 2004.

## SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 12, 2004

**Cowlitz Bancorporation**  
(Registrant)

By:

/s/ Richard J. Fitzpatrick

Richard J. Fitzpatrick, President and Chief Executive Officer

/s/ Donna P. Gardner

Donna P. Gardner, Vice-President, Chief Financial Officer



**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Richard J. Fitzpatrick, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cowlitz Bancorporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is likely to materially affect the registrant's internal control over financial reporting;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2004

/s/ Richard J. Fitzpatrick

Richard J. Fitzpatrick, Chief Executive Officer  
Cowlitz Bancorporation

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, Donna P. Gardner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cowlitz Bancorporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is likely to materially affect the registrant's internal control over financial reporting;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2004

/s/ Donna P. Gardner

Donna P. Gardner, Chief Financial Officer  
Cowlitz Bancorporation

**CERTIFICATION OF  
CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER**

This certification is given by the undersigned Chief Executive Officer and Chief Financial Officer of Cowlitz Bancorporation (the "Registrant") pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Each of the undersigned hereby certifies, with respect to the Registrant's quarterly report of Form 10-Q for the period ended September 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934;  
and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Richard J. Fitzpatrick  
Richard J. Fitzpatrick  
Chief Executive Officer  
Cowlitz Bancorporation

/s/ Donna P. Gardner  
Donna P. Gardner  
Chief Financial Officer  
Cowlitz Bancorporation

November 12, 2004